

INDUSTRY RISK REVIEW

MICROFINANCE INDUSTRY ANALYSIS

OVERVIEW

Microfinance refers to the provision of financial services to low-income individuals who are traditionally not served by conventional financial institutions. It is globally acknowledged and accredited for its role in fighting poverty, as evidenced by the many countries that use it. The microfinance industry in Uganda has witnessed significant growth and development over the past few decades. Microfinance institutions (MFIs) play a crucial role in providing financial services to the unbanked and underbanked population, particularly in rural and remote areas where traditional banking infrastructure is limited. As per the Alliance for Financial Inclusion (AFI), as of early 2024, the Uganda Microfinance Regulatory Authority (UMRA) had licensed 1,802 Tier 4 institutions, collectively serving approximately 17.5m clients, which constitutes a significant portion of the country's adult population. These institutions encompass Non-Deposit Taking Microfinance Institutions (NDTMIs), Savings and Credit Cooperative Organisations (SACCOs), Self-Help Groups, and commodity-based microfinance entities.

REGULATORY ENVIRONMENT

The regulatory framework for microfinance in Uganda is governed by the Uganda Microfinance Regulatory Authority (UMRA) and the Microfinance Institutions and Moneylenders Act of 2016. The regulatory environment has become more conducive, promoting transparency, consumer protection, and financial stability within the industry. Additionally, the Ministry of Finance imposed a maximum interest rate cap of 2.8% per month (33.6% annually) for moneylenders under the Tier 4 category, aiming to protect borrowers from exorbitant rates.

MARKET LANDSCAPE

The microfinance sector in Uganda comprises a diverse range of players, including traditional MFIs and savings and credit cooperatives (SACCOs) offering microfinance services. The sector is characterised by both regulated and unregulated entities, creating a mix of formal and informal financial service providers.

The microfinance industry in Uganda, as captured in the AMFIU Quarterly Report for Q3 2024, remains a vital engine for promoting financial inclusion. A total of 84 financial institutions submitted performance data during this quarter, including Microfinance Deposit-taking Institutions (MDIs), Microfinance Institutions (MFIs), and Savings and Credit Cooperative Organisations (SACCOs). Together,

these institutions managed an outstanding loan portfolio of UGX 2.65tn with over 1.17m borrowers, of whom 52.75% were women and 65.49% were rural borrowers. This reflects a strong emphasis on serving traditionally marginalised groups.

The Tier 4 Microfinance institutions comprise:

1. Non-Deposit Taking Microfinance Institutions (NDTMIs).
2. Savings and Credit Cooperative Associations (SACCOS).
3. Self-Help Groups.
4. Commodity-based Microfinance Institutions.

NON-DEPOSIT TAKING MICROFINANCE INSTITUTIONS (NDTMI)

A Non-Deposit Taking Microfinance Institution (NDTMI) is a company or non-governmental organization licensed by UMRA that participates in microfinance activities and assists in the development of micro, small and medium-sized businesses, as well as expanding access to microloan resources to individuals for the promotion of their businesses, livelihoods, and land holdings.

SAVINGS AND CREDIT COOPERATIVE ASSOCIATIONS – SACCOS

A SACCO is a voluntary society of association whereby members regularly pool their savings and may subsequently use the funds for various purposes, which may include, but are not limited to, making credit available to the members.

SELF-HELP GROUPS

A self-help group, by nature, carries out activities such as mobilising and managing its own savings, providing interest-bearing loans to its members, offering a limited form of insurance to its members, and sharing out member equity once a year in proportion to the savings.

COMMODITY-BASED MICROFINANCE

Commodity-based microfinance means the provision of microfinance services in the form of goods and services. Under the law, the recipient of a commodity shall not use that commodity for a purpose other than income generation.

CHALLENGES

Sustainability

Many MFIs in Uganda struggle with financial sustainability due to challenges such as high operating costs, limited access to funding, and the risk of loan default. Achieving a balance between social mission and financial viability remains a persistent challenge for microfinance institutions.

Risk Management

Effective risk management is essential for the long-term success of MFIs. However, many institutions face challenges in assessing and mitigating credit risk, operational risk, and external factors such as changes in economic conditions, regulatory requirements, and political instability. As per the AMFIU Quarterly Report for Q3 2024, some challenges were evident. Portfolio quality issues surfaced with the Portfolio at Risk (PAR) >30 days ratio exceeding recommended limits for MFIs and SACCOs. MFIs recorded a PAR >30 days of 8.02%, and SACCOs a worrying 10.74%, both above the recommended threshold of 3%. In contrast, MDIs managed a slightly better PAR of 3.62%, though still above the industry ideal.

Capacity Building

Building institutional capacity and enhancing the skills of microfinance practitioners are critical for improving the quality of financial services and ensuring compliance with regulatory standards. However, capacity constraints, particularly in rural areas, pose significant obstacles to the growth and development of the microfinance sector.

High Interest Rates

Microfinance institutions in the country charge high interest rates based on the cost of capital, personnel, administration, and loan loss. It is estimated that administrative costs amount to up to two-thirds of interest paid by clients. There is no universal system applicable across all MFIs on the calculation of interest rates. The interest rates applied are differentiated by product, product attributes, and features including loan type, cycle, amount, and duration.

Inadequate Working Capital

Most of the MFIs have inadequate working capital resulting from the poor saving culture of members and the inability to secure affordable and reliable financing sources.

Weak Institutional Capacity

MFIs face a set of interrelated challenges, such as limitations in the scale of their operations in terms of outreach and number of clients served; poor portfolio quality; limitations in their professional capacity; weak governance structure; poor accounting and record keeping; inefficient operations; and lack of financial discipline.

OPPORTUNITIES

Technology Adoption

The rapid advancement of technology presents opportunities for MFIs to enhance the efficiency, reach, and scalability of their operations. Digital financial services, mobile banking, and fintech innovations can help overcome geographical barriers and improve access to financial services for underserved populations.

Product Diversification

MFIs can expand their product offerings beyond traditional microcredit to include savings accounts, insurance products, remittance services, and financial literacy training. Diversification can increase revenue streams, attract new customers, and promote holistic financial inclusion.

Partnerships and Collaboration

Collaborating with government agencies, development organisations, private sector stakeholders, and community-based organisations can facilitate resource mobilisation, knowledge sharing, and the development of innovative solutions to address the needs of low-income households and micro-entrepreneurs.

FUTURE PROSPECTS

The microfinance industry in Uganda is poised for further growth and innovation as stakeholders continue to address the challenges and leverage opportunities in the evolving financial landscape. Strengthening regulatory oversight, promoting responsible finance practices, and investing in technology and human capital will be crucial for advancing financial inclusion and sustainable development goals in Uganda. Additionally, fostering an enabling environment for entrepreneurship, job creation, and economic empowerment will contribute to the resilience and prosperity of communities across the country.